

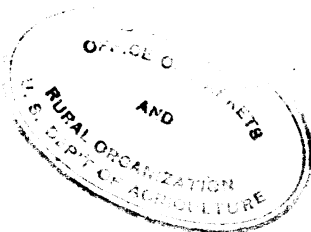
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HOW THE FEDERAL FARM LOAN ACT BENEFITS THE FARMER

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Contribution from the Office of Markets and Rural Organization

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THE Federal land banks, it is expected, will stand ready at all times to lend money to farmers on farm-mortgage security. The interest charges will be not more than 6 per cent. There will be no excessive commissions or bonuses. Loans will be made for periods ranging from 5 to 40 years. Annual or semiannual installment payments on the principal will be required, and further optional payments on the principal will be permitted after a loan has run 5 years.

The local loan associations will improve the credit of their members and reduce the cost of loans through the performance of definite services.

The bonds issued will be secured not only by farm mortgages deposited with the land bank registrar but also by the capital and surplus of the 12 Federal land banks. Both mortgages and bonds will be exempt from all forms of taxation.

The Federal Farm Loan Board of the Treasury Department has general charge of the system. The Department of Agriculture will cooperate with this board in supplying information and rendering assistance to farmers who desire to take advantage of the Federal Farm Loan Act, especially with reference to the organization of local loan associations.

HOW THE FEDERAL FARM LOAN ACT ¹ BENEFITS THE FARMER.

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INTRODUCTION.

THE Federal Farm Loan Act (approved July 17, 1916) makes provision for a system of 12 Federal land banks. Farmers desiring loans from such banks ordinarily will be required to become members of local national farm-loan associations.

The law also authorizes the organization of joint-stock land banks which may lend money directly to farmers. There is no assurance, however, that such joint-stock land banks will be organized in any given territory, because they are entirely dependent on private investors for their capital.

The organization of the Federal land banks without delay is assured, because the Federal Treasury will be drawn upon if necessary to raise the required capital. Every farmer in the United States will be included in the territory of one of the 12 Federal land banks, and every farmer, therefore, will have access to this system, provided he complies with the provisions of the law.

¹The general administration of the Federal Farm Loan Act is vested in the Federal Farm Loan Board of the Treasury Department. The membership of the board is as follows: William G. McAdoo, Secretary of the Treasury, chairman (ex officio); George W. Norris, Farm Loan Commissioner; Charles E. Lobdell; W. S. A. Smith; and Herbert Quick.

The Federal Farm Loan Act does not contemplate the lending of the Federal Government's cash or credit directly to the farmer. Such financial assistance as the Government gives merely guarantees the prompt establishment of the Federal land-bank system and its proper development and supervision.

With the aid of the mortgage banking facilities provided for in the act, it is believed that farmers generally will be relieved of many serious disadvantages to which they are subject under present conditions.

DISADVANTAGES UNDER THE PRESENT FARM-MORTGAGE LOAN SYSTEM.

The prevailing practice under the present farm-mortgage loan system in the United States involves certain disadvantages both to the borrower and to the lender. The borrower often pays excessive rates for interest and commission,¹ with additional charges for the abstract, for recording, etc. While interest rates may be relatively low in the more highly developed sections of the country, in these areas the borrower (even the man with well-established credit) is often forced in times of stringency to pay high rates for loans. The usual mortgage loan runs for a relatively short period of time, thus making it necessary to incur added expense for renewals. In many sections the borrower has no opportunity to pay off any part of his principal before maturity, and as a result the indebtedness remains undiminished to the end of the term.

The present system also subjects the lender to certain disadvantages which tend to prevent capital from seeking investment in farm-mortgage loans. Where a lender relies on his personal acquaintance with the conditions affecting such a loan he must have intimate knowledge of the farm mortgaged, must be assured of the validity of the land title, and must give attention to the upkeep of payments for taxes and insurance. He is often confronted with irregularity in the interest payments, due either to carelessness or to inability to pay on the part of the borrower. These considerations become all the more important in view of the fact that a considerable portion of the farm-mortgage loans in the United States are held by investors who exercise personal supervision with reference to their loans.

On the other hand, the investor who does not have a personal knowledge of the farm mortgaged to him and who must rely upon the representations of a third party is also subject to certain disad-

¹ See United States Department of Agriculture Bulletin 384, Costs and Sources of Farm-Mortgage Loans in the United States. 1916.

vantages. If he purchases the loan with some form of guaranty from a mortgage company or a mortgage bank, he must depend in the main upon the reliability of such mortgage company or bank, and while there are many such institutions that have established a reputation for reliability, the average investor is often in a position where he is not able to discriminate between those that make reliable representations and those that do not.

Moreover, there are important considerations connected with the form of a mortgage loan which make it relatively less convenient to the investor who has access to standardized securities in the investment market. Many investors will be more interested in farm-mortgage securities issued in the form of bonds in convenient denominations, running for uniform periods of time, with convenient and reliable means for the collection of interest payments.

ADVANTAGES UNDER THE FEDERAL LAND-BANK SYSTEM.

The Federal land-bank system is designed to do away, as far as practicable, with the disadvantages of the present farm-mortgage system. No loan will be permitted under the new system at a rate of interest exceeding 6 per cent. The rate of interest charged the borrower must not exceed by more than 1 per cent the interest paid on bonds which the Federal land banks are authorized to issue. Eventually, the net profits made by a Federal land bank, after paying expenses and setting aside the required reserve, will be returned to the local national farm-loan associations, to be distributed among the borrowers after the deduction of the expenses and reserve requirements of the local associations. One advantage thus expected to result from the new system is a substantial lowering of interest rates to farmers. Not only is the interest rate limited to 6 per cent, but provision is also made so that the farmer will escape the annoyance and expense of bonuses and commissions. He will pay only such extra charges in connection with the making of a loan as are approved under the rules and regulations of the Federal Farm Loan Board.

The loans must be made for relatively long periods of time, running not less than 5 nor more than 40 years. Each loan must make provision for annual or semiannual payments on its principal, so calculated that the debt will be entirely paid at the end of the period. After a loan has run for 5 years the borrower is given the option of paying any additional sum on the principal, in multiples of \$25, on any interest date. The following table shows the annual payments required on a loan of \$1,000, running for a period of 20 years, with interest at 5, 5½, and 6 per cent.

Amortization table for a loan of \$1,000, payable in 20 annual installments, with interest at 5, 5½, and 6 per cent.

Completed years.	Interest at 5 per cent.				Interest at 5½ per cent.				Interest at 6 per cent.			
	Payment.	Interest.	Applied on principal.	Principal still unpaid.	Payment.	Interest.	Applied on principal.	Principal still unpaid.	Payment.	Interest.	Applied on principal.	Principal still unpaid.
1.....	\$80.24	\$50.00	\$30.24	\$999.76	\$83.68	\$55.00	\$28.68	\$971.32	\$87.18	\$60.00	\$27.18	\$972.82
2.....	80.24	48.49	31.75	938.01	83.68	53.42	30.26	941.06	87.18	58.37	28.81	944.01
3.....	80.24	46.90	33.34	904.67	83.68	51.76	31.92	909.14	87.18	56.64	30.54	913.47
4.....	80.24	45.23	35.01	869.66	83.68	50.00	33.68	875.46	87.18	54.81	32.37	881.10
5.....	80.24	43.48	36.76	832.90	83.68	48.15	35.53	839.93	87.18	52.87	34.31	846.79
6.....	80.24	41.65	38.59	794.31	83.68	46.20	37.48	802.45	87.18	50.81	36.37	810.42
7.....	80.24	39.72	40.52	753.79	83.68	44.13	39.55	762.90	87.18	48.63	38.55	771.87
8.....	80.24	37.69	42.55	711.24	83.68	41.96	41.72	721.18	87.18	46.31	40.87	731.00
9.....	80.24	35.56	44.68	666.56	83.68	39.66	44.02	677.16	87.18	43.86	43.32	687.68
10.....	80.24	33.33	46.91	619.65	83.68	37.24	46.44	630.72	87.18	41.26	45.92	641.76
11.....	80.24	30.98	49.26	570.39	83.68	34.69	48.99	581.73	87.18	38.51	48.67	593.09
12.....	80.24	28.52	51.72	518.67	83.68	32.00	51.68	530.05	87.18	35.59	51.59	541.50
13.....	80.24	25.93	54.31	464.36	83.68	29.15	54.53	475.52	87.18	32.49	54.69	486.81
14.....	80.24	23.22	57.02	407.34	83.68	26.15	57.53	417.99	87.18	29.21	57.97	428.84
15.....	80.24	20.37	59.87	347.47	83.68	22.99	60.69	357.30	87.18	25.73	61.45	367.39
16.....	80.24	17.37	62.87	284.60	83.68	19.65	64.03	293.27	87.18	22.04	65.14	302.25
17.....	80.24	14.23	66.01	218.59	83.68	16.13	67.55	225.72	87.18	18.14	69.04	233.21
18.....	80.24	10.93	68.31	149.28	83.68	12.41	71.27	154.45	87.18	13.99	73.19	160.02
19.....	80.24	7.46	72.78	76.50	83.68	8.40	75.19	79.26	87.18	9.60	77.58	82.44
20.....	80.33	3.83	76.50	.....	83.62	4.36	79.26	.....	87.39	4.95	82.44	.....
Total.....	1,604.89	604.89	1,000.00	.....	1,673.54	673.54	1,000.00	.....	1,743.81	743.81	1,000.00	.....

The method of repaying loans described above has at least a two-fold advantage. It encourages the borrower in habits of thrift through the requirement of a systematic plan of paying off his debt, and at the same time it makes possible the placing of the farmer's loan at a lower rate of interest, inasmuch as the gradual reduction of the principal constantly improves the security for the balance—

that is, while the security remains the same the debt which is based thereon is all the time growing smaller.

The Federal land-bank system also improves the farmer's security still further through the cooperative efforts of the members of the local loan associations, as explained in detail below.

THE IMPORTANCE OF THESE ADVANTAGES TO AMERICAN AGRICULTURE.

Loans of the character authorized under the act will in many cases assist tenants and other landless men in the purchase of farms, since a loan amounting to 50 per cent of the value of the farm may be obtained on conditions which make it possible for the borrower to repay the indebtedness out of the farm income. Many farmers will find it advantageous, by reason of the better terms offered, to borrow money under the new system in order to pay off their existing indebtedness. Other farmers will be enabled to make needed improvements which they have hesitated to undertake before on account of the difficulty of obtaining loans on acceptable terms.

HOW THE GRANTING OF LOANS IS SAFEGUARDED.

Under the Federal farm-loan system it is not proposed to extend credit except on the basis of proper security. To begin with, each loan must be approved by a loan committee of the local association. Inasmuch as every loan carries the indorsement of the local association, the members naturally will be careful in recommending loans to the land banks. The proper granting of loans is safeguarded further by the provision for a salaried appraiser in each land-bank district, appointed by the Government, who must approve every loan before it is made by the land bank.

HOW THE MARKETING OF THE LOANS IS IMPROVED.

In place of selling the actual mortgages, the Federal land banks are authorized to issue bonds secured by an assignment and pledge of the mortgages, in denominations of \$25, \$50, \$100, \$500, and \$1,000. Because of the careful safeguards applied to these bonds they are expected to prove attractive to a large number of investors who desire to purchase reliable and convenient securities. In addition, it is believed that the bonds of small denominations will encourage saving and investment among individuals who have not heretofore been in the habit of making investments. Moreover, the bonds will be especially attractive because they, as well as the underlying mortgage securities, are exempt from all forms of taxation, as explained later.

WHO MAY OBTAIN LOANS FROM FEDERAL LAND BANKS.

Care has been taken to provide a system that does not give encouragement to speculative loans or to inflation in land values. All loans by Federal land banks are carefully restricted in the interests of general agricultural improvement.

In order to obtain a loan from a Federal land bank the borrower must agree to use the proceeds of the loan for one or more of certain objects specified in the act, namely, for the purchase of land for agricultural use; for equipment, fertilizers, and live stock for the land mortgaged; for buildings and other permanent improvements on said land; or, with certain limitations, for the payment of indebtedness. The borrower must furnish as security a first mortgage on farm land. The amount of the loan must be not less than \$100 nor more than \$10,000. The loan must not exceed 50 per cent of the appraised value of the farm land and 20 per cent of the value of the permanent improvements adequately insured. The borrower must be engaged, or about to be engaged, in the cultivation of the farm mortgaged. He will also be required, ordinarily, to become a member of a local national farm-loan association.¹

HOW TO ORGANIZE A LOCAL NATIONAL FARM-LOAN ASSOCIATION.

At least 10 prospective borrowers are necessary in order to organize a local national farm-loan association, and the aggregate amount which they wish to borrow must be not less than \$20,000. Every member is required by law to subscribe for shares of stock in the association (\$5 shares) equal in amount to 5 per cent of his proposed loan. Each association must have a board of not less than five directors, which board elects a president, a vice president, a secretary-treasurer, and a loan committee of three members. These officers, except the secretary-treasurer, must be shareholders of the association.

The Federal Farm Loan Board will supply model forms for articles of association and by-laws, application blanks for loans, and other necessary papers. After the articles of association are signed by the members, they must be forwarded to the Federal land bank of the district. These articles of association must be accompanied by a written report of the loan committee, such committee previously having appraised the farm-land security offered by each member and

¹The law provides that if, because of peculiar conditions in a given locality, local associations are not organized after the act has been in effect one year, the board may authorize the land bank to make loans in such locality through approved agents, said agents to be either banks, trust companies, mortgage companies, or savings institutions.

having duly indicated its approval on the application blank of each member. The loan committee's report must also include an affidavit showing that each of the members of the association has fulfilled the various requirements under the law and under the rules of the Federal Farm Loan Board.

The loan association is required to subscribe for shares of stock (\$5 shares) in the Federal land bank equal in amount to its own shares of stock, and this subscription for stock in the Federal land bank must accompany the other papers.

After a Federal land bank has received such articles of association, with the accompanying affidavit and stock subscription, the directors of said Federal land bank are required by law to send an appraiser to investigate the solvency and character of the applicants and the value of their lands, and to determine whether in their judgment a charter should be granted to the association. If the decision of the directors of the land bank is unfavorable the charter will be refused; if their decision is favorable the charter will be granted by the Federal Farm Loan Board, unless good cause can be shown for refusing it.

HOW THE LOCAL FARM-LOAN ASSOCIATION ASSISTS THE FARMER TO OBTAIN BETTER CREDIT.

The local loan association does not lend money to its members. Its function is to perform certain services for them so that they may be able to obtain loans from the Federal land bank on better terms than now prevail. It is important that every borrower should understand what the services are which a loan association renders its members.

One important service, rendered through the loan committee, is an appraisal of the property offered as security by each borrower. While this is not the only appraisal considered by the Federal land bank in connection with an application for a loan, it serves as an important guide, corresponding to the appraisals supplied by local agents under the present mortgage system.

The loan association also renders an important service by transmitting the necessary papers and reports through its secretary-treasurer to the Federal land bank. Besides clerical work of this character and the transfer of funds to and from the Federal land bank, the secretary-treasurer is required by law to ascertain whether borrowers use the proceeds of their loans in the manner specified and to notify the Federal land bank of any irregularities in this respect.

While the loan association supplies many kinds of important information to the Federal land bank, as indicated above, it also contributes directly to the financial standing of the mortgage loans

furnished to its members, in that the capital stock of the loan association carries a double liability which is added to the security represented by the members' mortgages. The local loan association is therefore to this extent a guaranty association for members' loans.

Still another important class of services will be rendered by the local loan association in accumulating investment capital. Each association is permitted to receive current deposits, giving therefor certificates bearing interest for not longer than one year, at not to exceed 4 per cent per annum, which certificates, when presented at the Federal land bank of the district in amounts of \$25 or any multiple thereof, are convertible into land-bank bonds.

It may thus be seen that the local farm-loan association constitutes an important cooperative organization which directly assists in improving the members' credit by rendering certain services which otherwise would have to be performed by other agencies at added expense.

HOW THE FEDERAL LAND BANK ASSISTS THE FARMER TO OBTAIN BETTER CREDIT.

Each Federal land bank will be an institution upon which the farmers of the district can rely at all times as a source for mortgage loans, provided they comply with the provisions of the law. To this institution the farmer can turn for loans, not only in normal times when there is a relatively good opportunity for obtaining investment capital, but also in times of stringency when even the farmer with well-established credit often finds it difficult under present conditions to obtain suitable loan accommodations on reasonable terms. The Federal land bank will be enabled to act as an ever-ready means of serving the farmer at all times, because of the nature of the plan under which it places the farmer's security on the market.

As already stated, the land bank will not undertake to sell the farmer's mortgage note direct to the investor, as is the usual method under the present system. On the basis of these mortgages and other guaranties provided for in the law, the Federal land bank issues bonds of various denominations. This function of converting the farmer's mortgages into land-bank bonds is the primary business of the Federal land bank.

Not only does the Federal land bank convert the farmer's securities into bonds, but its capital and surplus (minimum \$750,000) serves as added security for the protection of these bonds.

A third important service is rendered by the land bank in selling the land-bank bonds. The Federal land bank, because of its size and its prestige, through governmental connections, will have special

opportunities to reach the open investment market for the sale of these bonds.

All of the above-mentioned services, including the conversion of the farmer's mortgages into bonds, the protection of the bonds by the land bank's capital and surplus, and the sale of the bonds, are provided in order that investment capital may be readily obtained for the farmer at all times on as favorable terms as practicable.

THE RELATION OF THE FEDERAL GOVERNMENT TO THE SYSTEM.

There are various ways in which the Federal Government renders assistance, in order to insure the prompt establishment of the Federal land banks on a sound basis and the proper management of these banks. The main responsibility for the inauguration and supervision of the Federal land-bank system is vested in the Federal Farm Loan Board of the Treasury Department. The first important work of the board, under the law, is the designation of the 12 land-bank districts and the selection of the land-bank city of each district. The board also has the task of organizing each of the Federal land banks. This includes making provision for the necessary capital stock. To insure that the minimum capital stock (\$750,000) for each land bank will be subscribed for without delay, the law provides that, if any part of such stock remains unsubscribed for after 30 days from the time the books are opened for public subscription, it shall be the duty of the Secretary of the Treasury to subscribe for the unsubscribed balance. If necessary, the Federal Treasury is to subscribe for the entire minimum capital stock required for each Federal land bank.

The Federal Farm Loan Board appoints a temporary board of directors for each Federal land bank. After a Federal land bank has received subscriptions for its stock from local associations to the extent of \$100,000 a permanent board of directors of nine members is elected for each land bank. Six of the nine directors are chosen by the local associations and three directors appointed by the Federal board. The board also appoints other officials connected with the system, as hereinafter mentioned.

The Federal Government pays the salaries of the members of the Federal Farm Loan Board, of a registrar for each land-bank district, and of the bank examiners.

There is one special provision in the law under which the board may call upon the Treasury Department to make deposits of Government funds for the temporary use of the Federal land banks. The Secretary of the Treasury is authorized to use his discretion in making such deposits and must be satisfied with the security given by the Federal land bank. The law provides that these deposits must

not exceed \$6,000,000 in the aggregate at any one time, and that the interest rate thereon must not exceed the interest charged for other Government deposits.

EXEMPTION FROM TAXATION.

The capital, surplus, and income of the Federal land banks and the local loan associations, together with all mortgages accepted and bonds issued under the act and incomes derived therefrom, are exempt from Federal, State, municipal, and local taxation.

THE WORK OF THE FEDERAL FARM LOAN BOARD.

The Federal Farm Loan Board, consisting of the Secretary of the Treasury and four additional appointees of the President,¹ as already stated, has general charge of the administration of the Federal Farm Loan Act. The board not only performs the temporary work of getting the Federal land-bank system established; it constitutes a permanent body of Government officials, charged with the general supervision of the land banks and loan associations created under the law. The board appoints the farm-loan registrars, land-bank appraisers, and land-bank examiners; it receives reports from the land banks and the local farm-loan associations; it approves the legal forms and blanks used by the land banks; and its approval is also required for each issue of bonds made by any land bank under the act.

THE DEPARTMENT OF AGRICULTURE COOPERATES.

While the Federal Farm Loan Board of the Treasury Department has charge of the administration of the law and will conduct investigations and diffuse information with reference thereto, the Department of Agriculture, through the Office of Markets and Rural Organization, which has conducted extensive investigations in matters pertaining to farm credits, will cooperate with the Federal board in supplying information and rendering assistance to farmers who desire to take advantage of the Federal Farm Loan Act, especially with reference to the organization of local loan associations. Section 3 of the law specifically provides for the use of the Department of Agriculture as a distributing agency for information regarding the Federal Farm Loan Act. Various agencies of the department, including the extension workers in the several States, will be utilized in this work.

¹ See footnote, p. 1.

